Office - Supreme Court, U.S.
FILED
NOV 22 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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INTEREST OF AMICUS CURIAE

The Interstate Natural Gas Association of America ("INGAA") is a non-profit national trade association representing virtually all of the major long-distance natural gas transmission companies in the United States. These companies conduct their operations over a broad geographic area, including jurisdictions in each of the federal circuits which have issued conflicting decisions on the issues involved in this case.

Nearly all of INGAA's members are public companies subject to the financial reporting requirements of the federal securities laws and all are subject to the federal tax laws. Accordingly, the ultimate resolution of the question whether the IRS may freely summon such tax pool analyses, either from the companies themselves or their inde-

pendent accountants, is a matter of vital concern to INGAA's members. For the reasons stated herein, INGAA urges this Court to grant The El Paso Company's ("El Paso") petition for a writ of certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit in this case.

CONSENT OF THE PARTIES

Amicus is filing this Brief with the consent of both parties, whose letters of consent have been filed with the Clerk.

SUMMARY OF ARGUMENT

The Fifth Circuit has ruled in this case, contrary to decisions in other circuit courts, that a company's confidential review and analysis of its contingent federal tax liability is not privileged material and may be summoned by the Internal Revenue Service ("IRS") under 26 U.S.C. § 7602. Its ruling on the question of the relevance of the tax pool analysis under 26 U.S.C. § 7602 conflicts directly with the Tenth Circuit's decision in *United States v. Coopers & Lybrand*, 550 F.2d 615 (1977), and implicitly with the Eighth Circuit's decision in *United States v. Matras*, 487 F.2d 1271 (1973). Its ruling that El Paso's tax pool analysis is not privileged conflicts with the Second Circuit's decision in *United States v. Arthur Young & Co.*, 677 F.2d 211, *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687).

These conflicts * have arisen because of fundamental differences of viewpoint among the circuits on the law and on the proper balance to be struck between the competing public policies implicated in this case. Most importantly, the courts have disagreed on their assessment of the IRS's need for information contained in tax pool analyses, the extent to which the law permits IRS access to

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* These and other instances of conflict on these issues are discussed in El Paso's petition at 11-17.

these analyses, and the extent to which IRS access to these analyses will inhibit the free flow of information between public companies and their independent auditors necessary to the full financial disclosure required by the securities laws. The courts have also disagreed on the question of the fairness of requiring the taxpayer to disclose its negotiating and settlement positions to the IRS.

It is INGAA's position that the issues underlying these fundamental disagreements have now been fully explored in the decisions of the Circuit Courts, and that these issues, both because of their importance and because of the conflicts in the circuits, should now be addressed by this Court. Accordingly, INGAA urges the Court to grant El Paso's Petition For a Writ of Certiorari.

THE TAX POOL ANALYSIS

As is more fully set out in The El Paso Company's petition, at 3-5, a tax pool analysis contains a company's private theories and speculations concerning which issues on its return may be subject to challenge by the IRS, whether the company would find it worthwhile to litigate any or all of these issues if raised, the likely outcome of any disputes if litigated, and the dollar amounts for which the company might be willing to settle these disputes administratively if it chose not to litigate them. The goal of conducting such an analysis is to arrive at a dollar estimate of the outcome of all such disputes. If the dollar amount is material, the company will show the amount as a contingent liability on the audited financial statements filed periodically with the Securities and Exchange Commission ("SEC"). While the company will make public the bottom-line dollar estimate arrived at in its tax pool analysis, the document itself and any underlying material will, as a general rule, be kept confidential and will not be disclosed to the SEC. The SEC requires only that the company's independent auditor review the

analysis in accordance with generally accepted auditing standards.

Tax pool analyses may be prepared by a company in-house or by its outside independent auditors. In either case, however, the document itself and any supporting materials are evaluative, not factual, in nature. The IRS seeks tax pool analyses, not because it cannot conduct an audit without them, but rather because the confidential judgments of the company's tax advisers contained therein provide a "road map" for the audit and, presumably, a very useful guide in any subsequent settlement negotiations. *See Arthur Young, supra*, 677 F.2d at 218-221. In short, the IRS summons these analyses for reasons of its own administrative convenience, not because it would be unable to fulfill its audit function without them.

ARGUMENT

I. Important Considerations of Public Policy Dictate that the Fifth Circuit's Decision be Reviewed by This Court

In its decision, the Fifth Circuit balanced the IRS's need for tax pool analyses against the public policy expressed in the securities laws mandating full financial disclosure, and ruled in favor of permitting the IRS access to tax pool analyses. In its brief policy analysis, the court concluded that the quality of financial reporting would not be diminished at all by permitting IRS access to tax pool analyses. Noting that public companies have a legal obligation to prepare such analyses, the court reasoned that "corporations will [not] dishonor their legal obligations by discontinuing the preparation of tax pool analyses." Appendix to Petition of the El Paso Company for a Writ of Certiorari (hereinafter "App.") at 27a.

This assumes erroneously that the only two choices available to a corporation are to comply or not. As explained above, however, a tax pool analysis is by necessity

a collection of highly subjective judgments to which no strict scale of correct and proper disclosure may be applied. There are many degrees of acceptable disclosure. The free and critical exchange of ideas between a company and its independent auditor necessary to develop a full, worst-case analysis of potential tax liability cannot help but be inhibited when it is clear both to the company and its auditor that any exchange between them may become the subject of compelled testimony at a subsequent IRS summons enforcement proceeding. It is undoubted that corporations will continue to produce tax pool analyses as required by law, but it is equally certain that these analyses will be less thorough and searching than before, even though in full compliance with law, if they, or testimony concerning them, may be subject to IRS scrutiny. It is this inhibition of the most full and candid exchange possible between auditor and client, and the ultimate ill effect this will have on the quality of those analyses and financial reporting in general, that is a matter of deep concern requiring the Court's attention.

A second public policy concern meriting this Court's attention is the manifest unfairness of requiring the taxpayer to disclose its negotiating and settlement positions without placing a corresponding requirement on the Government. There can be little doubt that any controversies arising between the taxpayer and Government as a result of an audit involve an adversary process, *see Arthur Young*, *supra*, 677 F.2d at 219-220; Kurtz, *Discussion on "Questionable Positions,"* 31 Tax Law. 13, 14 (1978), yet no such unfairness would be countenanced in an ordinary adversary proceeding.

This is not a case where the taxpayer is suspected of fraud or is trying in bad faith to avoid paying tax due. The Fifth Circuit expressly recognized that the many ambiguities and gray areas of the tax code "guarantee that a large corporation has many opportunities to choose *in good faith* an interpretation of the tax code that leans

toward lessening its taxes." App. 5a (emphasis added); *accord Arthur Young*, *supra*, 677 F.2d at 220. Consequently, the IRS has no need to use this information to establish intent to evade taxes. Moreover, as discussed above, it does not need this information to provide the facts needed for its audit.

It is very likely, then, that the IRS practice of compelling the disclosure of this information based upon considerations of its own convenience, will be perceived as unjust and as an abuse of power. Since our system of taxation is founded on the principles of self-assessment and voluntary compliance, any perception of Government unfairness is inherently damaging to the foundation of that system. Thus, this issue is one of fundamental importance to our tax system and should be considered by this Court.

II. Tax Pool Analyses and Supporting Materials are Privileged and Should Not be Subject to IRS Summons Power

In addition to the public policy concerns identified above, this case presents in a clear and factually uncomplicated setting important questions concerning both the scope of the work product privilege recognized in *Arthur Young* and the attorney-client privilege. On the work product question, the decision of the court below is in clear conflict with the Second Circuit's *Arthur Young* decision, even though the Fifth Circuit decision skirts any in-depth discussion of *Arthur Young*.

In *Arthur Young*, the Second Circuit considered whether a tax pool analysis prepared and maintained by the taxpayer's independent accountant could be summoned by the IRS under section 7602. The court balanced the IRS's need for the analysis in carrying out its function under the tax laws against the public interest expressed by the securities laws in full financial disclosure. Finding that the IRS sought the analysis principally for reasons of

time and efficiency, and that the harm caused to financial reporting by permitting free access to tax pool analyses would be significant, the court recognized a work product privilege to protect such analyses. This privilege was intended to protect such analyses from disclosure unless the IRS could make a showing of sufficient need to outweigh the policy considerations dictating the analyses' protection. The court's intent in *Arthur Young*, it said, was to protect "the integrity of the independent auditing process." 677 F.2d at 221.

While this privilege protected an analysis which was in the hands of the taxpayer's accountant in *Arthur Young*, the court's reasoning is equally applicable where the analysis is sought from the taxpayer itself. The decision would be meaningless if the IRS, denied access to the analysis by the accountant, could then obtain it, or testimony concerning it, from the taxpayer, yet that is the effect of the Fifth Circuit's decision. The Fifth Circuit acknowledges this conflict only obliquely (App. 19a n.13), and largely ignores the import of the *Arthur Young* holding. It is clear, however, that these decisions are in direct conflict, and that the legal issue considered in *Arthur Young* is presented with equal force in this case.

Even if El Paso's tax pool analysis were not protected by the work product doctrine, it should be protected by the attorney-client privilege. The Fifth Circuit acknowledged that under this Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), the attorney-client privilege applies in this context, but held that El Paso waived the privilege by disclosing the analysis to its independent auditor. App. 19a. The court relied on this waiver theory even though it was clear that the disclosure of parts of the analysis to the independent auditor was required by law, and even though the confidence was preserved by the auditor. This is not a case where a party invokes the privilege, but then freely discloses the privileged information to others when it is beneficial to do so.

See Green v. Crapo, 181 Mass. 55, 62 N.E. 956, 959 (1902) (Holmes, J.). Rather, it is a case where all precautions have been taken to preserve the confidentiality of the privileged information, and where a limited disclosure has been made, in confidence, in order to comply with the law. The Fifth Circuit's decision constitutes a significant and harmful limitation of the attorney-client privilege and, as noted in El Paso's petition at 16-17, conflicts with decisions of other circuits which hold that a partial disclosure does not constitute a complete waiver of the privilege.

In light of the importance of the work-product and attorney-client privilege issues raised by this case, the considerable confusion the Fifth Circuit's decision has produced concerning the scope of those privileges, and the need to resolve the conflict in the circuits on these issues, INGAA urges this Court to grant certiorari.

III. Tax Pool Analyses are Not Relevant Within the Meaning of 26 U.S.C. § 7602

When balanced against the significant harm to the public interest in reliable financial statements and to taxpayers' interests in preserving the confidential nature of their discussions with accountants and attorneys, the IRS's need for the information contained in tax pool analyses is of secondary importance. It is clear that the IRS does not need to obtain access to tax pool analyses in order to execute its function under the internal revenue laws. As in El Paso's case, the factual material necessary to the audit is ordinarily provided on an ongoing basis during the course of the audit in response to specific requests by the IRS. There is little doubt that access to tax pool analyses may make some aspects of an audit faster and easier for the IRS, but a mere showing of convenience has been held insufficient to establish relevance. *United States v. Matras*, *supra*, 487 F.2d 1271 (IRS denied ac-

cess to taxpayer's proposed budget). As noted above, the tax pool analysis sought in this case, and tax pool analyses in general, do not contain facts not otherwise provided, or available, to the IRS. Moreover, where fraud is not charged, the analysis is not needed to establish intent.

The IRS and the Fifth Circuit both suggest that any information which might shed light upon a taxpayer's return is relevant under 26 U.S.C. § 7602. The Tenth Circuit held in *Coopers & Lybrand*, however, that a higher standard must be met. This standard requires, among other things, a showing of a specific need for the information sought, its unavailability elsewhere, and a realistic expectation that the information is contained in the document sought. Applying this test to a situation closely analogous to that presented in this case, the Tenth Circuit held that the tax pool analysis was not relevant under section 7602.

The Fifth Circuit squarely rejected the Tenth Circuit's holding (App. 11a) in this case (as has the Second Circuit in *Arthur Young*, 677 F.2d at 218, and *United States v. Noall*, 587 F.2d 123 (1978), *cert. denied*, 441 U.S. 923 (1979)) leaving the law on the relevance question in a state of confusion. Because of these conflicts, the importance of the question, and the basic unfairness of providing the IRS unrestricted access to companies' documents in this situation, this Court should review the relevance issue.

CONCLUSION

The issues of law and public policy raised by this case are of deep and immediate concern to INGAA's member companies, as indeed they are to all public companies subject to the financial reporting requirements of the securities laws. The conflicting positions on these important issues have been crystallized in a series of circuit court decisions over the past decade and are now ready for re-

view by this Court. Further delay in their ultimate resolution is unlikely to lead to any further development of the issues, and will perpetuate the harmful uncertainty created by the conflict in the circuits. For these reasons the members of INGAA urge the Court to grant El Paso's Petition for a Writ of Certiorari on all issues.

Respectfully submitted,

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